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MILLENNIUM CHALLENGE CORPORATION

[MCC FR 14-04]

Notice of Entering into a Compact with the Republic of Ghana

AGENCY: Millennium Challenge Corporation.

ACTION: Notice.

SUMMARY: In accordance with Section 610(b)(2) of the Millennium Challenge Act of 2003 (22 U.S.C. 7701-7718), the Millennium Challenge Corporation (MCC) is publishing a summary of the Millennium Challenge Compact between the United States of America, acting through the Millennium Challenge Corporation, and the Republic of Ghana. Representatives of the United States Government and Ghana executed the Compact documents on August 5, 2014. The complete text of the Compact has been posted at mcc.gov.

Dated: August 8, 2014.

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Summary of Millennium Challenge Compact with the Republic of Ghana

1. Overview.

MCC's Board of Directors has approved a five-year, \$498.2 million compact with the Republic of Ghana aimed at reducing poverty and accelerating economic growth (the "Compact"). The Compact is intended to assist the Government of Ghana ("GoG") to increase economic growth by addressing problems in the power sector through private sector investment in power generation and distribution as well as improvements that will reduce load shedding, power losses, and outages that currently affect millions of Ghanaians (the "Program"). The Program will support the turnaround of Ghana's electricity sector and stimulate private investment to create a self-sustaining sector meeting the current and future needs of households and business while ensuring inclusive access to power by its citizens.

2. Program Overview and Budget.

The Compact focuses on turning around the main public electricity distribution company through the introduction of private sector participation as well as targeted infrastructure investments and reforms in power generation. The targeted investments and reforms will jointly contribute to a more functional, credit worthy, and self-sustaining power sector.

Due to the desire to create sustainable change and economic growth, MCC has made the Compact contingent on private sector participation ("PSP") as well as reforms intended to improve the financial position of the distribution utilities, enable gas supply for the energy sector, and ensure a cost reflective tariff regime. In addition, MCC included a second tranche of conditional program funding to be made available only if essential reforms milestones are met, including actual implementation of the PSP transaction and continued progress toward a cost reflective tariff.

The Compact includes base funding of \$308.2 million and conditional funding of up to \$190 million which would be released only after significant agreed-upon reforms are adopted by the GoG. The budget is shown in Figure 1 below.

Figure 1: Proposed Ghana Compact Budget Overview

| Compact Budget Overview (Millions of US\$) | | | |
|--|---------------------------------|---|-----------------------------------|
| Projects | MCC Tranche I (Base Funding) | MCC Tranche II (Conditional Incentive Funding) | Potential Total MCC Funding |
| ECG Financial & Operational Turnaround Project | 149.6 | 190 | 498.2 |
| NEDCo Financial & Operational Turnaround Project | 54.2 | | |
| Regulatory Strengthening & Capacity Building Project | 5.0 | | |
| Access Project | 10.0 | | |
| Power Generation Sector Improvement Project | 16.3 | | |
| Energy Efficiency & Demand Side Mgmt. Project | 25.4 | | |
| Monitoring & Evaluation | 7.6 | | |
| Program Administration and Oversight | 40.2 | | |
| Total Investment | 308.2 ¹ | 190 | |

As the required conditions are met, the Tranche II funding that is part of the overall Compact will be allocated to the Electric Company of Ghana Financial and Operational Turnaround Project. If the conditions to the release of Tranche II funding are not met within two years of Entry into Force of the Compact, the \$190 million will be de-obligated from the Compact.

The Government of Ghana will contribute at least 7.5 percent of the total amount of MCC funding towards the implementation of the Compact.

The Program can be divided into two general areas: projects that focus on the distribution sector, and projects that focus on the generation sector.

3. Distribution Sector Investments.

Utility Reforms: Electricity Company of Ghana (“ECG”) and Northern Electricity Distribution Company (“NEDCo”) Financial and Operational Turnaround Project

¹ Numbers do not add due to rounding.

The ECG Financial and Operational Turnaround Project, totaling \$149.6 million, pursues a two-pronged approach – changing the governance and management of this Ghanaian electric utility by bringing in a private sector operator coupled with infrastructure and foundational investments designed largely to reduce losses and improve service quality. Specifically, the Project contains the following five interconnected activities:

- Private Sector Participation. Accepting the reform program as a condition of the Compact will signal Ghana’s willingness to take bold moves to improve an underperforming sector that drags down economic growth in the country.
- Modernizing Utility Operations. Investments to support integrated loss management, such as technical assistance, to provide overall project management support.
- Reduction in Commercial Losses and Improvement of Revenue Collection. Reducing distribution system vulnerability to theft and meter manipulation and improving metering systems, including installation of pre-paid meters.
- Technical Loss Reduction. Interventions focused on lowering thermal losses in the distribution systems.
- Outage Reduction. Reducing both the frequency and duration of outages by introducing improved system protection and sectionalizing devices in the distribution system.

The estimated economic rate of return (“ERR”) for the ECG Financial and Operational Turnaround Project is 19 percent. The initial estimated beneficiaries of this Project are 4.8 million people in the short term and 7.8 million people long-term.

The NEDCo Financial and Operational Turnaround Project will initially provide \$5 million in technical assistance to improve operations of NEDCo. No later than the conclusion of

the first year of Compact implementation, MCC will evaluate ERRs for possible system and infrastructure investments and if resulting ERRs are acceptable, MCC will make investments up to \$49.2 million.

Regulatory Strengthening and Capacity Building Project

The activities under the Regulatory Strengthening and Capacity Building Project, which totals \$5 million, are two-fold – tariff review, focused on the process of ratemaking and more specifically on the structure of tariffs, and capacity building of the sector performance monitoring capabilities to ensure better reporting:

- Sector Performance Monitoring Capacity Building. Improving the regulatory monitoring and independent verification of sector performance.
- Tariff Review and Regulation. Improving the tariff review process by supporting studies that will provide critical inputs to the redesign of the tariff structure prior to implementation of the PSP and the next round of ratemaking and technical assistance to the regulators.

The economic and beneficiary analyses combine the Regulatory Strengthening and Capacity Building Project with the ECG Financial and Operational Turnaround Project calculations as the results of the two Projects are closely linked.

Access Project

The Access Project, totaling \$10 million, will test the most cost effective approaches to address the key constraints that micro, small and medium enterprises (“MSMEs”) face in obtaining safe and legal access to electricity. This small Project is designed to be innovative and experimental – it will test several different interventions aimed at reducing critical barriers to legal connections for MSMEs in a small sample of markets and economic enclaves and provide evidence of effective approaches to increasing legal access for the distribution utilities. In

addition to the direct benefits the Project would have for the MSMEs, increasing access will also expand the customer base of the utilities to include these important stakeholders and ensure that they are beneficiaries of improvements in the Ghanaian power sector. The Access Project will also address the problems caused by illegal connections, improve safety and security in target areas, and strengthen relationships between end users, local government, and the utility companies. The Project includes two activities:

- Improving Electricity Supply to MSMEs and Social Institutions. Upgrades will be made to target selected markets and economic enclaves that are within the intervention sites of the ECG and NEDCo Financial and Operational Turnaround Projects, and to the extent possible, nearby social institutions. The activity will also provide metered public lighting in the targeted areas.
- Improving Service Delivery and Strengthening Partnerships. This activity will seek to alleviate the various barriers (including a high connection fee, cumbersome connection processes and weak coordination among key actors including utility companies, local government and the communities) that prevent MSMEs from having legal access to electricity.

These activities are expected to contribute to increased incomes for MSMEs; firm ERRs for this Project, however, are not yet available. At this time, data needed to undertake an assessment of the proposed intervention is still being collected. Robust economic evaluations will identify promising interventions that could be scaled up during or after the compact and will provide evidence of effective strategies for increasing access to electricity in markets and enclaves across Ghana.

4. Generation Sector Investments.

The generation sector investments adopt two strategies to make more energy available. The first is to make better use of the electricity already in the system by reducing waste. The second is to foster an enabling environment for investments to expand generation capacity.

Power Generation Sector Improvement Project

This \$16.3 million Project prioritizes the alleviation of major constraints to private sector investment in generation through the following three activities:

- Operationalize the “Gas to Power” Value Chain. The lack of reliable fuel supply is a significant barrier to securing affordable and sustainable generation capacity and has led to unplanned load shedding and outages in the past few years. The Compact will leverage ongoing advisory support provided by USAID by providing both the impetus to act (achievable, action-oriented conditions precedent linked to first disbursement of project funds) and continued support to the GoG to ensure that decisions regarding institutionalization, commercialization, and securitization of the gas sector are informed and serve Ghana’s best interest.
- Facilitate Liquefied Natural Gas (LNG) Development. Studies have shown that even with gas from domestic sources and the West African Gas Pipeline, Ghana will need additional fuel to support projected increases in electricity demand. The private sector has expressed an interest in building the required infrastructure associated with importing LNG and MCC is funding the technical feasibility studies required to provide a ‘shovel-ready’ project.
- Strengthen Sector Planning and IPP Framework. Ghana does not have an active and integrated master plan to guide the development of its growing energy sector, or an established competitive process for procuring Independent Power Providers (“IPPs”).

This has led to uneven, opaque, and costly additions to capacity that may not be consistent with a least cost plan. The activity will support the development of a least cost plan that addresses generation, transmission, distribution and demand side management in a holistic and integrated fashion, as well as capacity building within the entities responsible for sector planning. It will also allow the Government to conduct more effective strategic planning for the electricity grid and off grid systems and provide generation capacity from both traditional and renewable sources.

The estimated ERR for this Project is 24 percent. The initial beneficiaries of the Project are 19.6 million people and the long-term beneficiaries are 41.8 million people.²

Energy Efficiency and Demand Side Management Project

Energy efficiency and demand-side management policies and investments represent some of the most cost-effective means to bridge the gap between supply and demand, serving as sources of new energy supply. Reducing energy waste on the consumer side of the electricity meter decreases the growth of demand and reduces the investment that is needed in the electricity system to maintain needed capacity and reliability. This \$25.4 million Project includes four activities:

- Development and Enforcement of Standards and Labels. Most energy-using products do not have standards or labelling requirements and the standards that do exist would benefit greatly from technical updates and enforcement support.
- Improved Energy Auditing. Energy efficiency auditing and energy services company market support includes technical capacity-building for energy efficiency and energy management professionals.

² This is a 20-year projection based on a population growth rate of 2.3 percent.

- Education and Public Information. Awareness, education, and information activities help assure that both technical workers and the general public are aware of cost-effective energy saving opportunities.
- Demand Side Management Infrastructure. This activity would support piloting of distributed applications such as solar photo voltaic back-up power for lighting and electronics, off-grid solar systems, and grid-connected solar systems as well as the conversion of conventional street lights to LED street lighting.

The estimated ERR for this Project is 27 percent. The estimated beneficiaries for this Project are 19.6 million people in the short term and 41.8 million people long-term.³

5. Policy Reform Milestones.

The Compact is tied to a number of reforms, specifically: improving the creditworthiness of ECG, ensuring reliable gas supply for power generation, instituting a cost reflective tariff, and commercialization of the distribution utilities. The GoG has given MCC certain assurances through the negotiations process of its support for the policy, regulatory, and institutional reform agenda reflected in the Compact and associated conditions precedent, and that indeed those reforms in the Program are in line with actions the GoG is already taking and believes are necessary to ensuring a well-performing energy sector. The proposed two tranche approach to Compact funding was also discussed with the GoG and accepted as an important component of the program design.

MCC required the GoG to meet a set of five policy reform milestones prior to presenting the Compact to the Board for approval. In line with its commitment to the Compact, the GoG has met each of these milestones, as described below.

³ See footnote 2.

- Approval of the Gas Sector Action Plan. An acceptable short-term Gas Sector Action Plan was submitted to MCC by the Minister of Energy and Petroleum. The GoG, with the support of the World Bank, is currently drafting a comprehensive long-term gas sector master plan, which will be complete by the end of 2014. Approval of the terms of that gas sector master plan by MCC and its adoption by the GoG are conditions to entry into force of the Compact.
- Finalize the Jubilee gas supply agreement. The Ghana National Gas Company (“GNGC”) and Jubilee Partners have signed the agreement related to infrastructure needed for gas supply from the Jubilee gas fields. This agreement facilitates the completion of infrastructure by GNGC that complements private sector infrastructure and is a necessary predicate to commercial agreements to be signed in the future.
- Agree to PSP option for ECG and NEDCo. The details of the agreement were discussed during Compact negotiations and are memorialized in the compact document.
- Submit an action plan to substantially reduce GoG arrears to ECG and implement plan to move Government Ministries, Departments and Agencies to regular and current payment of utility bills. The Minister of Finance provided a letter to MCC on June 30, 2014 detailing the total amount of arrears owed to ECG by the GoG and outlining a projected path to repayment.
- Continue quarterly tariff adjustments. Ghana’s utility regulator, the Public Utilities Regulatory Commission, announced a quarterly tariff adjustment on June 27, 2014. The new tariff took effect on July 1, 2014.

These were not easy milestones to meet, and they are instrumental to achieving the deep and lasting change MCC and the GoG want to achieve in the energy sector through the Compact. MCC is confident that the GoG's strong commitment to reform will continue as the Program moves forward.

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